In the Supreme Court

OF THE

United States

OCTOBER TERM, 1944

No.

MAY R. KIEFERDORF,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

REFERENCE TO OFFICIAL REPORT OF THE OPINIONS DELIVERED IN THE COURTS BELOW.

There are three prior opinions in this case. The first is by the Tax Court of the United States reported in 1 T.C. 772 (promulgated Mar. 16, 1943) and found in the record of this case at pages 21 to 31 followed by a dissenting opinion. The third opinion is by the United States Circuit Court of Appeals for the Ninth Circuit and is reported in 142 Fed. (2d) 723 (filed May 6, 1944) and is found in the record of this case at pages 51 to 58, inclusive.

II.

A CONCISE STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

The decision of the United States Circuit Court of Appeals was entered on May 6, 1944. (R. 51.) A petition for rehearing before said Court was denied on June 2, 1944. (R. 60.)

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended (28 USCA 347(a)) and petitioner also relies upon Rule 38, paragraph 5(b) of this Court. Jurisdiction is also sustained by Section 1008 of Revised Statutes, 28 USCA 350.

The following cases are believed to sustain jurisdiction:

Phillips v. Commissioner of Internal Revenue (1931), 283 U.S. 589;

Hulburd v. Commissioner of Internal Revenue (1935), 296 U.S. 300.

III.

A CONCISE STATEMENT OF THE CASE.

In the estate in probate of her late husband petitioner filed a petition requesting that the property in said estate exempt from execution be set aside to her. This was a right granted to petitioner under California law.[5] A judgment of the Probate Court was

[5]The statutory provision concerned is set forth in the Appendix of this brief, being Section 660 of the California Probate Code.

entered granting petitioner's petition; thereafter, the executor of the estate paid and delivered the property in the estate exempt from execution (proceeds of certain insurance policies) to petitioner. The executor of the estate in probate did not pay the income tax due as a result of income received by the decedent during the last year of his life. The Commissioner of Internal Revenue thereupon assessed the income tax of the decedent against petitioner as a transferee under the provisions of Section 311 of the Internal Revenue Code.[6] (R. 16-20, inclusive.)

Petitioner resisted this assessment before the Tax Court of the United States which in its decision sustained the Commissioner, two judges dissenting including the judge who tried the case. (R. 20, 32.) A petition for review was filed in the United States Circuit Court of Appeals for the Ninth Circuit. The Circuit Court affirmed the determination of the Tax Court. (R. 59.)

The facts out of which the controversy arose were stipulated to before the Tax Court and are set forth in the Record. (R. 16-20, inclusive.)

IV.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals for the Ninth Circuit erred in affirming the majority opinion of the Tax Court in the following particulars:

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[6]The pertinent provisions of Section 311 of the Internal Revenue Code are set forth in the Appendix to this brief.

1. In finding that petitioner under the facts here presented was a distributee within the meaning of that word as used in Section 311 of the Internal Revenue Code.

2. In finding that petitioner had incurred transferee liability where under the State law no such liability was incurred.

3. In failing to show that petitioner was liable at law or in equity for the tax of another.

4. In failing to consider Section 1119 of the Internal Revenue Code (26 USCA 1119) which places on the Commissioner the burden of showing that a petitioner is liable as a transferee.

V.

SUMMARY OF ARGUMENT.

(a) PETITIONER IS NOT A TRANSFEREE OR DISTRIBUTEE WITHIN THE MEANING OF THESE WORDS AS USED IN SECTION 311 OF THE INTERNAL REVENUE CODE.

Under the factual situation in this case it is the contention of petitioner that she is neither a *transferee nor a distributee* under any recognized definition, lay or legal, of these words.

(b) TRANSFEREE LIABILITY IS DETERMINED AT LAW OR IN EQUITY UNDER STATE LAW, AND UNDER CALIFORNIA LAW NO TRANSFEREE LIABILITY WAS CREATED.

For the purpose of argument only, it is assumed but not admitted that petitioner may be deemed a transferee. That transferee liability is determined by local law is established by at least three decisions of the Circuit Courts of the United States. In the present case petitioner incurred no transferee liability under local law. Thus she was not liable for the tax of another.[7]

(c) THE BURDEN TO SHOW TRANSFEREE LIABILITY WAS ON THE COMMISSIONER AND THIS BURDEN HAS NOT BEEN SUSTAINED.

Section 1119 of the Internal Revenue Code (26 USCA 1119) provides that the burden of showing transferee liability rests on the Commissioner. This section is entirely ignored in the decision of the Circuit Court of Appeals. The record can be searched from cover to cover and all that is disclosed is a situation where no transferee liability exists under California law. The Commissioner has shown no statute, decision or fact to create transferee liability. Thus the Commissioner has failed entirely in sustaining the statutory burden of proof placed upon him.

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[7]Supporting cases are cited under "ARGUMENT" following.

VI.

ARGUMENT.

(a) PETITIONER IS NOT A TRANSFEREE OR DISTRIBUTEE WITHIN THE MEANING OF THESE WORDS AS USED IN SECTION 311 OF THE INTERNAL REVENUE CODE.

Section 311 of the Internal Revenue Code, Subsection (f) defines "transferee" as follows:

> "* * * the term 'transferee' includes heir, legatee and distributee".

The process under which petitioner obtained property from the estate of a decedent has already been generally indicated and was in accordance with an express provision of the California law, Section 660 of the California Probate Code.[8] Acting under this section, petitioner, contrary to her own interest as an heir or legatee in the estate, to the interest of other heirs and legatees, to the interests of all creditors, and exercising an independent statutory right, filed a petition calling for the exercise of judicial discretion. Her petition was granted and in accordance with the mandate of the Probate Court, what she had petitioned for was delivered to her. There is nothing in this process which even remotely would constitute petitioner a transferee or distributee under any definition of these words.

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[8]This section, which is set forth in the Appendix to this Brief, provides that a widow may have set aside to her property in the estate exempt from execution. The particular property here concerned was the proceeds of insurance policies having an annual premium of less than $500. Such proceeds are exempt from execution under the California exemption statutes. California Code of Civil Procedure, Section 690.19.

Procedure under Section 660 of the Probate Code has been considered by the California Courts on numerous occasions and the decisions make it clear that petitioner did not take as an heir, distributee or legatee but obtained whatever she received as result of favorable action on a petition predicated upon an independent statutory right. In *Estate of Kennedy* (1910), 157 Cal. 517, 522, 108 P. 280, the Court, speaking of property set aside to a widow, said:

> "What the widow takes under such orders of the probate court she does not take by will. It is equally clear that she does not take property so set apart by the probate court 'by the intestate laws of this state.' The language 'pass, by will or by the intestate laws of this state' means to pass by virtue and force of the law of this state governing testate or intestate succession. (*In re Joyslin's Estate,* 76 Vt. 88 [56 Atl. 281].) 'The term "Intestate laws" is intended to cover the statute of descents which relates to the descent of real estate, and the statute of distribution which provides for the distribution of the personal property of decedent after the payment of his debts, * * * and after the setting apart to the widow and minor children of the exemptions specified * * * These exempt articles are in no way governed by the statute of distribution.' "

In *Estate of Ettlinger* (1943), 56 C. A. (2d) 603, 607, 132 Pac. (2d) 895 the Court, speaking of the nature of a widow's right in relation to a probate homestead, which is of the same nature as the right to exempt property, stated:

> "Here the widow is not seeking any right as an heir or beneficiary under the will. She is merely

> pursuing her statutory right to seek a family allowance and a probate homestead."

In spite of the foregoing the Circuit Court of Appeals found that petitioner took as a distributee. In accomplishing this the Court relied upon a further definition of "distributee" found in Regulations 94 for the Act of 1936 in which the Treasury Department defined the words "transferee" and "distributee" as follows:

> "The term 'transferee' as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, *and all other classes of distributees.*" (R. 54.) (Emphasis supplied by Circuit Court.)

However, this general language in the Regulations does not appear to add anything to the meaning of the word "distributee". The word "distribution" is defined in Webster's International Dictionary, Second Edition (1934) as

> "act of distributing; apportionment among several or many; as, *distribution* of gifts"

and a "distributee" is

> "one to whom something is distributed."

In legal terminology the word "distributee" has an even narrower meaning. It means one who takes personal property from an estate in probate where the decedent dies intestate.

"*Distributees.* The persons who are entitled under the statute of distribution to the personal estate of one who has died intestate."

Bouvier's Law Dictionary, Rawle's Third Revision (1914) Vol. I, p. 896.

"As we are considering the meaning and intent of the word as used in the Act of Congress, we are inclined to agree with the government that, as distinguished from an heir, it should receive the more general and universal interpretation, namely, that a 'distributee' is one entitled to the personal property of an intestate under the laws of distribution."

Parrott Estate Company v. McLaughlin (1937), 89 F. (2d) 188, 190.

Thus under neither the lay nor legal definition of the word "distributee" does it appear that petitioner would even remotely come within the definitions. Applying the well known doctrine of *ejusdem generis* and recognizing that if statutes are to have a meaning, words used must be given their usual definitions, the term "and all other classes of distributees" does not appear to add anything to the definitions found in Section 311 itself.

When we speak of the word "transferee" our mind immediately connects with this the moving party, i. e., "transferor." In the case presented petitioner was the moving party. She utilized the processes of law to obtain a judgment in her favor which could have been enforced against the estate with all the usual powers of the Court. She was no

more a transferee than one who sues another on a promissory note and obtains a judgment which is realized out of the assets of the defendant. In summary, the situation here presented does not fall within that covered by Section 311 of the Internal Revenue Code.

In conclusion it should be emphasized that although the amount concerned is small in the present case, the principle involved is of great importance because practically all States of the Union have statutes similar to the one here considered and the rights of widows under existing federal tax legislation should be clarified.

(b) TRANSFEREE LIABILITY IS DETERMINED AT LAW OR IN EQUITY UNDER STATE LAW, AND UNDER CALIFORNIA LAW NO TRANSFEREE LIABILITY WAS CREATED.

(1) State law determines transferee liability.

This portion of the argument is based upon the assumption, which petitioner does not admit, that she may be deemed a transferee. At the present time it is well settled that Section 311 of the Internal Revenue Code does not purport to create transferee liability but merely authorizes a more effective remedy for enforcing a liability which must exist at law or in equity quite independent of the statute in question. In *Phillips v. Commissioner of Internal Revenue,* (1930), 283 U.S. 589, 594, 75 L. Ed. 1289, 1295, this Court in considering this section said:

"Section 280(a)(1)[9] provides the United States with a new remedy for enforcing the existing 'liability at law or in equity.' The quoted words are employed in the statute to describe the kind of liability to which the new remedy is to be applied and to define the extent of such liability."

The Circuit Courts in at least three cases have definitely stated that this liability at law or in equity must be found under the laws of the State where the transaction occurred.

"In Hatch v. Morosco Holding Co., 50 F. (2d) 138, we expressed the view that section 280 imposes no new obligation upon the transferee of property of a taxpayer, but permits collection from him, by a summary procedure *to the extent that the municipal law makes him liable at law or in equity for the transferor's taxes.*"

Harwood v. Eaton (1933), 68 Fed. (2d) 12, 13.[10]

"In the statutory method of collecting income taxes is provided the liability of transferees of the taxpayer. That liability is 'the liability, at law or in equity, of a transferee of property of a taxpayer.' Int. Rev. Code, §311(a)(1), 26 U.S.C.A. Int. Rev. Code §311(a)(1). *Whether a transferee is liable 'at law or in equity' depends upon State law.*"

Botz v. Helvering (1943), 134 Fed. (2d) 538, 542.

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[9]The reference is to Sec. 280(a)(1) of the Revenue Act of 1926, which is now Sec. 311 of the Internal Revenue Code.

[10]Emphasis supplied unless otherwise indicated.

> "This section 'provides the United States with a new remedy for enforcing the existing "liability, at law or in equity" ' of a transferee. Phillips v. Comm., 283 U.S. 594, 51 S. Ct. 608, 610, 75 L. Ed. 1289. It does not create or impose an obligation not already fixed by municipal law. It merely provides a summary remedy for its direct enforcement. Phillips v. Comm., supra. Hatch v. Morosco Holding Co. (C.C.A.), 50 F. (2d) 138. In short, the act is procedural only, operating to put in the place of the taxpayer a transferee of his who has received money or property under circumstances making the transfer void or voidable as to creditors."
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> *Liquidators of Exchange Nat. Bank of Shreveport v. United States* (1933), 65 F. (2d) 316.

No Court has held that such liability is created under any federal legislation or doctrine. Certainly since *Erie R. Co. v. Tompkins* (1938), 304 U.S. 64, there can be no separate federal judicial rule for the purpose of determining liability in a situation such as is here considered. We are thus perforce compelled to ask what the California Courts of last resort have said.

(2) Under California law no transferee liability exists.

The California Courts have very definitely, without question, determined that where a widow takes property from an estate in probate under Section 660 of the California Probate Code, she takes it free and clear from the claims of all creditors of the estate.

> "The manifest object of the section (1465) is the support of the family and to make provision for

their support and maintenance. These demands of the family are deemed superior to those of the heirs or creditors."

Estate of Pillsbury (1917), 175 Cal. 454, 458, 166 Pac. 11, 13.[11]

"It is settled in this state, contrary to some jurisdictions, that exempt property passing to the persons designated in Section 660, *supra,* is, by virtue of the provisions of that section free * * * from the debts of the decedent * * *"

Estate of Crosby (1935), 2 Cal. (2d) 470, 474, 41 Pac. (2d) 928, 930.

As to the California rule there can be no doubt and thus if transferee liability is determined by local law, petitioner incurred none and the decision of the Circuit Court of Appeals is in error.

(3) Liability cannot be found under federal law.

The next question is whether transferee liability of petitioner can be found under any existing federal law. Here it must be emphasized that we are not concerned with the question of whether Congress could by appropriate legislation create what may be called "federal transferee liability." Our question is whether Congress has done so. As already indicated, Section 311 of the Internal Revenue Code did not create transferee liability but merely set forth a remedy to be used where such liability exists at law or in equity. Since *Erie R. Co. v. Tompkins,* supra,

[11]The statutory reference is to Section 1465 of the California Code of Civil Procedure. This section now appears as Section 660 of the California Probate Code.

there certainly can be no "federal liability at law or in equity" founded in "general law" and outside of legislation.

A survey of the various situations where there is an established rule recognizing a dominance of federal law over state law, indictates that petitioner's situation is not covered by any such rule.

We are not here concerned with whether the federal government could reach the property concerned through its process of distraint or whether State exemption statutes would be effective. The reference in Section 660 of the Probate Code to property exempt from execution is used merely as a convenient means of definition. If such property remains in the estate, even under California law it would not be exempt from execution. *Estate of Starr* (1920), 183 Cal. 121, 190 Pac. 625. It is freely admitted that the insurance proceeds in the hands of petitioner would be subject to *her* federal tax indebtedness; the principal question is how did petitioner become liable for the tax of another where under local law there is no transferee liability?

Neither are we concerned with the question of whether or not the federal government is bound by procedural requirements in probate proceedings in relation to the presenting of claims, or whether the federal government is bound by State statutes of limitation. No tax lien is involved in the present case. Rules granting priority to debts due the United States are not involved. The estate of the decedent in question was not indebted to petitioner.

We are solely concerned with a property right vested in petitioner under California law. In this connection and in considering the impact of federal tax legislation upon State law, this Court in *Helvering v. Stuart* (1942), 317 U.S. 154, 163, 87 L. Ed. 154, 159, said:

> "Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability. Recently in dealing with the estate tax levied upon the value of property passing under a general power, we said that 'state law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.' "

To paraphrase the language just quoted, State law creates or denies liability in various situations involving transferees. The Internal Revenue Code in Section 311 merely designates a summary method of collection where liability has been created by State law. Federal legislation does nothing more. To the best knowledge of petitioner her case is the first where transferee liability has been inflicted in the face of State law to the contrary.

A simple reading of Section 660 of the Probate Code of California is sufficient to indicate that it is one defining and creating property rights. This section in itself does not exempt any property from execution. It merely defines a situation and the type of property that upon judicial determination may be transferred from one ownership to another. The section is concerned with the vesting of title to property and the matter is thus one particularly within the

province of the State. In *Cannon v. Nicholas* (1935), 80 F. (2d) 934, 936, the Court said:

> "The Supreme Court of the United States, in the Community Property and other cases, has held that state law determines the ownership of property subject to its jurisdiction, and that a wife's property cannot be taken for her husband's taxes. Poe v. Seaborn, 282 U.S. 101, 51 S. Ct. 58, 75 L. Ed. 239; Hoeper v. Tax Commission, 284 U.S. 206, 52 S. Ct. 120, 76 L. Ed. 248."

In effect the determination of the Circuit Court of Appeals in this case is a reversion to *Swift v. Tyson* (1842), 16 Pet. 1, in that the Federal Court ignores what the State Courts have said and applies its own conception of where liability should exist. This philosophy no longer exists in our judicial system since *Erie R. Co. v. Tompkins,* supra.

In view of the foregoing the question may be properly asked as to how the Circuit Court of Appeals reached the conclusion which it did. The crux of the decision is found in the following language contained therein:

> "Furthermore, it is the opinion of this Court that in the last analysis the Federal Government can collect the taxes due whether the petitioner is a transferee under the California law or not on the principle that the California law cannot create exemptions from execution or attachment for the collection of Federal taxes." (R. 56.)

In the foregoing statement there are two fundamental errors which vitiate entirely the Court's deci-

sion. In the first place the Court states that even if petitioner was not a transferee, the Government could collect the taxes. The Court forgets that the entire proceeding is predicated on the assumption that petitioner was a transferee. Secondly, whether California law can or cannot create exemptions from execution or attachment for the collection of federal taxes, rests on the intent of Congress. In speaking of the relation between federal and state legislation in the collection of taxes, this Court in *Helvering v. Stuart* (1942), 317 U. S. 154, 161, said:

> "The intention of Congress controls what law, federal or state, is to be applied."

Referring again to the majority decision of this Court in relation to Section 311 of the Internal Revenue Code (*Phillips v. Commissioner of Internal Revenue,* supra) it is clear that the necessary implication from the language of the section with which we are concerned, is that transferee liability is determined by state law. Congress might create transferee liability, but to the best knowledge of petitioner has not done so in the situation here considered.

In brief, the determination of the Circuit Court of Appeals is contrary to all known applicable federal and state decisions.

(4) Social and economic significance.

The decision of the Circuit Court of Appeals in this case also has a deeper social and economic significance than is indicated by the particular facts con-

sidered. The statute under which petitioner took in the present case is a part of the general humanitarian policy of the State to the effect that it is better in the long run for a widow to be supported and a family maintained as a unit than to permit creditors to take their pound of flesh. This statute is also based on the conception that it is better for the earnings of a husband accumulated over a lifetime to pass in part to the widow or minor children than to satisfy creditors including the tax collector and to create candidates for public charity. Thus petitioner's case is concerned with much more than property rights alone. The expressed social policy of the State in relation to the security of widows and orphans is also involved. While in cases where it is permissible under the Constitution, the Federal Government may render State legislation ineffective, it should pause and carefully balance all values where more than monetary interests must be considered.

This case also has an additional economic significance in another sense. In order for the federal tax system to have the respect and cooperation of the taxpaying public, it must operate under and in accordance with law. Arbitrary action is always the parent of avoidance and evasion.

(c) THE BURDEN TO SHOW TRANSFEREE LIABILITY WAS ON THE COMMISSIONER AND THIS BURDEN HAS NOT BEEN SUSTAINED.

Section 1119 of the *Internal Revenue Code* (26 USCA 1119) reads as follows:

> "(a) *Burden of proof.* In proceedings before the Board the burden of proof shall be upon the Commissioner to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax."

The Circuit Court of Appeals in its decision in petitioner's case has entirely ignored this most important provision. All that the record shows is a situation where the property passed from one ownership to another and where under California law there was no resultant transferee liability. Far from showing transferee liability, all that the Commissioner has shown in this case is a factual situation where under local law there is no transferee liability. The importance of this section cannot be over emphasized because we are here concerned with an extraordinary legal situation, i.e., where one individual becomes liable for the tax of another. In order to establish this more than a mere scintilla of support is required. The burden is not on petitioner to show that no transferee liability exists, but directly and by mandate of Congress upon the Commissioner to show such liability. There is an entire failure on the part of the Commissioner in this respect and this failure which is fundamental to the decision of this case has been entirely ignored by the Circuit Court of Appeals.

VII.

CONCLUSION.

Petitioner respectfully urges:

1. That she is not a transferee or distributee within the meaning of these words as used in Section 311 of the Internal Revenue Code;

2. That if she may be deemed a transferee, then transferee liability is determined by local law and under local law transferee liability was not incurred;

3. That the Commissioner of Internal Revenue has not sustained his statutory burden of proof to show transferee liability;

4. That the case is important because it strikes at a fundamental humanitarian policy of the State and overrides State property law in a situation which exists generally throughout the United States;

5. That the case as now decided constitutes taxation without legislation and amounts to blind judicial concurrence in arbitrary administrative action.

Petitioner's case taken by itself is small; however, its implications are far reaching and injustice is not measured in terms of dollars. This case is the first clear cut holding that transferee liability for federal taxes can be sustained in the absence of liability under State law. A hearing in this Court is required both because of the novelty of the doctrine which appears contrary to *Erie R. Co. v. Tompkins* and the universality of the factual situation.

The Petition for Writ of Certiorari to the Ninth Circuit Court of Appeals should be granted and upon a full hearing the judgment should be reversed.

Dated, San Francisco, California,
July 31, 1944.

Respectfully submitted,
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Attorney for Petitioner.

KENNETH M. JOHNSON,
Of Counsel.

(Appendix Follows.)